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Taxation Laws Amendment (Superannuation Contributions) Bill 2000

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Taxation Laws Amendment (Superannuation Contributions) Bill 2000

Date Introduced: 7 September 2000

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent. However, the amendments have differing application dates which will be dealt with in the Mains Provision section.

Purpose

To deny a deduction in respect of a superannuation contribution made to a non-complying fund or made in respect of a taxpayer who is also the employee in respect of whom the contribution was made and to impose fringe benefits tax on contributions made in respect of a person other than an employee.

Background

Employee Benefit Arrangements and Superannuation

Measures contained in the Bill address superannuation aspects of what have become know as 'employee benefit arrangements'(EBAs). The arrangements involve a number of schemes which may allow deductions and classify certain activities as not subject to tax and which are designed to increase the remuneration for people in a position to conduct financial transactions through their control, or association with control, of various entities. EBAs generally fall within four categories, two involving superannuation, another employee share scheme and fourthly employee benefit trusts. EBAs have been subject to arguments, though not decisive decisions, regarding their eligibility for favourable tax treatment. While this Bill deals only with superannuation EBAs, the history of the various EBAs is often intertwined and this background will deal with the generic concept of an EBA where relevant, including in relation to the Australian Taxation Office's (ATOs) position on the schemes and the implications of any legislative response.

Controlling interest superannuation schemes feature a company controlled or owned by a taxpayer or their associate. The company makes a gift to the taxpayer, who is an employee of the company, in circumstances which aim not to trigger a fringe benefits tax (FBT) liability. The taxpayer/employee subsequently makes a superannuation contribution for his/her self to a superannuation fund and claims a deduction for the contribution. The contribution is received by the superannuation fund in such a way that it is aimed not to be classified as a taxable contribution. The contribution may be made to either a complying or non-complying superannuation fund and will often not remain within the fund, especially where the contribution is made to a non-complying fund.

Offshore superannuation schemes feature an employer or their associate who makes a contribution to an offshore, non-complying superannuation fund. The contribution is claimed as a deduction and is made in such a manner that it aims not to give rise to a FBT liability, principally as the employee is not a member of the fund when the contribution is made. The employee/taxpayer will then be invited to join the fund, usually through making a contribution. The employee's contribution is financed by the fund and liabilities associated with the loan are met from the employer contribution. The fund is established in a manner and place which aim to make it exempt from Australian tax.

Both of these schemes have the features of seeking to transfer funds from an employer to an employee without giving rise to a tax liability for the employee or a FBT liability for the employer and generating tax deductions for the contributor. The schemes operate through technical interpretations of various provisions of income tax and fringe benefits tax laws and have operated for some time. They are also characterised by being actively promoted to wealthy taxpayers and not being available to 'ordinary' employees.

Rulings and Opinions

The validity and promotion of such schemes has been related to the availability of binding private rulings from the ATO. It appears that arrangements with very similar characteristics to current EBAs were put to the ATO for consideration and advice as early as 1988 and were approved by the ATO in private binding rulings (PBRs) after the rulings system was introduced in 1992. As the name suggests, PBRs are binding on the ATO for the case in which the ruling was given. Opinions, which are not legally binding but are followed by the ATO as normal administrative practice, were also apparently given in favour of the arrangements.[1] Arrangements substantially the same as those approved in a private ruling or opinion were then promoted on the basis that if they were disputed by the ATO a ruling could be sought based on the earlier approval. It appears that for a number of years the arrangements were accepted by the ATO and relevant deductions allowed and tax not imposed on certain transactions relating to overseas funds and contributions which may have otherwise attracted FBT and the superannuation contributions surcharge.

The ATO responded to the arrangements in October 1998 by issuing a draft FBT ruling on the meaning of the term 'associate'.[2] The draft ruling, which dealt with employee benefit

trusts and contributions to non-complying superannuation funds but applies to all the EBAs, provided that a trustee could be an associate of an employee, even though no employee was a beneficiary of the trust at the time the benefit was provided to the trustee, so long as an employee subsequently became a beneficiary in connection with the arrangements for the benefit to be provided to the trustee. The effect of the ruling was that the trustee would be an associate of an employee for purposes of the FBT and so the employer would be liable for FBT on the value of the benefit provided. In a Media Release associated with the Draft Ruling the ATO stated:

> The public ruling today makes clear the Tax Office view that the structures used in these employee benefit arrangements do not avoid the concept of associate. They are therefore subject to FBT under the clearly intended operation of the law.
>
> The ruling identifies a range of vehicles used for this purpose, including non-complying superannuation funds and unit trusts. Both offshore and on-shore arrangements are involved.[3]

However, it should be noted that a draft ruling has no legal effect and only reflects the preliminary views of the ATO. Draft rulings cannot be relied on by either the ATO or taxpayers. It is also worth noting that a subsequent public ruling will not override a prior private ruling unless it results in an improvement for the taxpayer. The result is that if a private ruling had been received in respect of a particular arrangement it cannot be overturned by a subsequent public ruling and it may be possible to prevent the ATO from bringing a court action contrary to a private ruling on the basis of estoppel.[4]

The draft ruling was replaced by a final ruling on 19 May 1999 which was the same in its effect as the draft ruling. The final ruling notes that it 'does not apply to taxpayers who have received a Private Ruling …. and have implemented the arrangement ruled on, in substantially the same terms as the Private Ruling.'[5]

Prior to the release of the final ruling, the ATO announced on 26 March 1999 that it would issue no more PBRs and advance opinions in relation to EBAs while it investigated the area. The move was described as 'the next step in tackling aggressive tax planning in this area.'[6] The embargo on the issuing of PBRs was lifted on 19 May 1999 following an internal review of the ruling system.[7]

As noted above, a PBR is binding on the ATO while advance opinions are not. PBRs will apply only to the circumstances detailed in the application for which the ruling was made and under section 14AS of the *Taxation Administration Act 1953* the ruling may specify the arrangement to which it applies. The difference between opinions and binding rulings, and the extent of coverage of the rulings is crucial to the ATOs further action.

In a Media Release accompanying the release of the final ruling the ATO announced its position on the validity of various EBAs, including the superannuation arrangements covered by this Bill, stating:

> We are bound under law to stand by our rulings. While not bound at law, administratively we adhere to our advance opinions because this is in the public interest. In the present case, I [the Commissioner] consider that the balance of the public interest was in not adhering to these opinions.
>
> In the event, I have not felt the need to reach a conclusion on this because we consider that these private binding rulings and advance opinions are unlikely to have any practicable application.
>
> This is because the arrangements we have seen have not been implemented according to the facts presented. In what is a highly competitive marketplace arrangements are often hastily marketed on the basis of abbreviated summaries. Little attention is paid to fully implementing the originally submitted arrangements.
>
> Further, our advice was premised on the express purpose of the arrangements – a purpose that was lost in their marketing and implementation.[8]

The Media Release was also indicated that if taxpayers voluntarily came forward prior to 30 June 1999 to remit any tax benefit gained under such an arrangement they would be subject to minor penalties only and the ATO was willing to take the matter to the High Court if necessary.

The statement gives a good indication of the grounds on which the ATO could defend the issue of amended assessments aimed at claiming back tax benefits initially allowed under the arrangements.[9] It is also worth noting the degree of reliance placed on the way in which an arrangement has been implemented, so that if a private binding ruling (PBR) had been given and the arrangements carefully implemented recovery will be very difficult if not impossible.

Promotion of EBAs

The degree to which promoters relied on private rulings was dealt with in evidence given by ATO officials to the Standing Committee on Employment, Education and Workplace Relations inquiry into employee share ownership. The evidence deals with all EBA schemes and states that less than 100 PBRs were made in respect of EBAs and that the ATO was reviewing the activities of 40 promoters of EBAs whose clients made contributions of approximately $1.5 billion. When asked ‘ So you are saying that the aggressive promoters of these schemes are doing so without the benefit of any private rulings?’ the ATO official replied ‘Mostly that is the case.’ The official further commented ‘They take their own advice, often from counsel or other sources. Some promoters take advice from the ATO, but that is a very small number.’[10]

In addition to potentially being based on PBRs, however loosely, certain arrangements also depend on the interpretation to be placed on various provisions of taxation law and complex arguments can be expected in any test cases on their validity.

The effect of the rulings on the promotion and uptake of the various EBAs is difficult to judge except in general terms. In regard to the ATO offer for people to self-declare involvement in EBAs and receive minor penalties only, evidence given to the Standing Committee on Employment, Education and Workplace Relations by an ATO official was that approximately one-third of people have come forward, with the ATO needing to take recovery action to recoup the remainder.[11] The promotion and uptake of various EBA schemes appears to have slowed considerably since the release of the draft and final rulings which would impose FBT on the arrangements[12], although promotion of derivatives of the arrangements dealt with by the ATO apparently continue to be promoted. There appears to be a difference between the continued promotion of EBAs based on superannuation and employee share and trust schemes. An ATO official stated on 11 May 2000 that:

> Employee benefit share schemes and employee benefit trusts are no longer being marketed widely in the community…[13]

while the Media Release announcing the measures contained in the Bill states:

> This move is necessary following Tax Office advice that these arrangements are still being actively promoted. The arrangements have continued despite the Taxation Commissioner's clear advice that the schemes are ineffective under existing law.[14]

This was confirmed by the Commissioner in a recent speech, 15 November 2000, where it was stated:

> Variations of employee benefit arrangements continue to be developed and promoted, despite the fact we made it abundantly clear that we would tackle this sort of activity, including by using the general anti-avoidance provisions.[15]

As the Bill deals solely with superannuation EBAs these statements suggest that since the rulings promotion has concentrated on superannuation EBAs, although promotion of other schemes continued. This may reflect a view by the promoters that superannuation EBAs stand a greater chance of being held to be valid under existing tax law. However, their continued promotion may indicate that some promoters are less concerned with the potential effect on taxpayers who purchase their arrangements and that some taxpayers are entering into such schemes unaware of the ATOs views on such arrangements.

Courts or Legislation?

The process of instituting legal action to enforce the ATOs interpretation of the law in relation to EBAs, including superannuation EBAs where contributions were made before the commencement of this Bill, and to recover amounts previously not taxed or allowed as deductions is likely to be drawn out. Once a test case has been identified it is likely (due to the sums of money involved) to be contested by the parties to the High Court,

a process which could take years. Ideally, a test case would need to cover all of the issues relevant to EBAs and also be contested. The ATO appears to be having some difficulty in finding a suitable test case. In May 2000 the ATO expected that the first cases would be in the Federal Court 'in a matter of months'.[16] There have been no reports of any cases yet being commenced by the ATO.

The alternative to a test case would be to amend the assessments of all parties to EBAs and wait for a challenge to the amended assessments. In addition to arguments relating to specific provisions of the tax law, the ATO will, as noted by the Commissioner, proceed under the general anti-avoidance provisions contained in Part IVA of the *Income Tax Assessment Act 1936* (ITAA36). To fall within Part IVA it is necessary to show that there was a scheme, that a tax benefit was obtained and that there was a sole or dominant purpose of obtaining a tax benefit. While the first two of these may be relatively easily shown, the third could be more difficult, particularly in relation to superannuation EBAs where saving for retirement could be argued as the primary purpose for entering into the arrangement.

The first case in this area has been initiated by the Remuneration Planning Corporation Pty Ltd (RPC) which commenced a case in the Federal Court on August 2000 to have TR99/5, the final ruling on the meaning of 'associate', declared invalid. It is argued that the ATOs power to make rulings relates only to how the law will apply in the future and that rulings cannot be made relating to transactions which have already taken place. RPC is reported to have marketed more than 200 employee benefit trusts over a 10 year period and to have alleged that TR99/5 would apply FBT 'contrary to the position adopted in its earlier rulings to the applicant during 1988-92.'[17] If this action were successful it could have a significant impact on the ATOs ability to recover amounts it considers owed under EBAs. Directions hearings in the matter were held on 4 October and 23 November 2000 and it may be some time before the case is finalised.

An alternative to relying on the courts would be to legislate to prevent EBA schemes. However, as the schemes have been operating for a number of years and their promotion of other EBAs appears to have markedly decreased, legislation will only be able to recoup amounts allegedly owed to the Commonwealth if the legislation were retrospective. The explanatory memorandum to the Bill estimates that its expected financial impact is 'negligible'. This appears to recognises that superannuation EBAs will not be widespread after the announcement of the legislative change, although other EBAs may continue to be promoted as indicated by the Commissioner (see above). However, this legislation, or similar legislation specifically prohibiting other forms of EBAs from the date of announcement, will not be able to recoup money previously lost. This would, in the absence of successful court action, require retrospective legislation.

The position of the ATO would appear to be that it would prefer to attempt the litigation path before recommending retrospective legislation. In evidence given to the Standing Committee on Employment, Education and Workplace Relations inquiry into employee

share ownership relating to share ownership EBAs, but which is equally applicable to other varieties of EBAs, an official of the ATO stated their general approach to the area:

> Let us hypothetically think of advice that perhaps we could give to government. One would be 'We think we will counter these arrangements under existing law,' and to the extent to which they are able to be counted that way, the revenue will be protected, ultimately. But if the courts were to find against us on any of these issues, then the amount at risk, to use the words we used beforehand, is very substantial and you might have to think about legislation – indeed, retrospective legislation – at that point. The alternative is to do something legislative now.[18]

As noted above, the problem of prospective legislation at this stage is that recovery of amounts committed to EBAs before the commencement of the legislation may only be recovered by successful court action.

Turning to the question of retrospective legislation, the first point that must be made is that retrospective legislation, particularly where it has a negative effect on individuals, is very unusual. In relation to taxation, the Senate Scrutiny of Bills Committee has been critical of the practice of legislation being backdated to the date a measure was announced, a procedure which has become common place in relation to changes to taxation legislation. As 'legislation by press release', a term used to refer to the practice of backdating legislation to the date of announcement, is now a well established practice in tax legislation, retrospective legislation will be taken to mean legislation which was not previously announced.

The best, and most well known, example of retrospective legislation in taxation relates to the 'bottom of the harbour' schemes prevalent in the 1970s and 1980. The *Taxation (Unpaid Company Tax) Act 1982* specifically addressed such schemes and, although it came into force on 13 December 1982, applied to arrangements entered into between 1 January 1972 and 4 December 1980 (section 5 of the Act). This followed considerable public opposition to the artificial paper schemes involved in those arrangements.

The Assistant Treasurer announced on 18 February 2000 the intention to legislative retrospectively to overrule the High Court's decision in *Commissioner of Taxation v Mercantile Mutual Insurance* which overturned a Ruling which had been used by both industry and the ATO since the 1991-2 year of income.[19] However, retrospective legislation of this type, which affirms established practice accepted by both taxpayers and the ATO, should be distinguished from the type of retrospective legislation which would adversely affect the position of the taxpayer as would be necessary in this case.

The main purpose of retrospective legislation in relation to EBAs would be to protect the revenue and to enable recovery regardless of the result of court action. If the government intends to follow the approach of testing the matter in the courts and, if unsuccessful in relation in a substantial amount of lost revenue to retrospectively legislate, it may seem more efficient to legislate at this stage, avoiding the costs to all parties involved in what promises to be extended court action. If there is to be retrospective legislation the next

question to be asked is when it should apply from? There appears to be a choice between the time when the EBAs were first promoted and when the ATO made its views public regarding the disallowance of the schemes, ie. the date of the draft ruling. It is interesting to speculate as to whether if all draft and/or final rulings were accompanied by a Media Release stating an intention to legislate from that date if the ruling was overturned this would be sufficient to place such legislation into the category of 'acceptable' retrospective legislation noted above.

A problem with the legislative option, whether prospective or retrospective, is the wide range of possible arrangements to be covered (although this would be less of a problem with retrospective legislation as the arrangements to be covered would be known). In response to a question concerning the suitability of a legislative response to employee share EBAs an ATO official made the following comment which is equally applicable to other EBAs and 'aggressive tax planning' in general.

> One of the issues in our addressing these employee share plans is that we are not dealing with a static beast, we are dealing with an evolutionary creature that at one stage looks like this, then the legislation comes in and it changes its face. So, while the legislation may provide a hard edge, it is only a hard edge for a short period of time because… there is a thirst by promoters to develop something new in the marketplace.[20]

This was seen as a reason for the ATO preferring to first use the general anti-avoidance provisions of Part IVA which could have a more general application if successfully applied.

The measures contained in this Bill were announced by the Assistant Treasurer in a Press Release dated 30 June 2000 and are intended to apply from the time of announcement, with, as noted above, the reason given for the legislation being that superannuation EBAs are still being actively promoted. The explanatory memorandum to the Bill estimates that it will have negligible financial impact.

This Bill has been referred to the Senate Standing Committee on Superannuation and Financial Services, which is due to report by 4 December 2000.

Main Provisions

Section 82AAE of the ITAA36 allows a deduction for contributions made to a non-complying superannuation fund if the contribution is made for the provision of superannuation benefits for an eligible employee. Section 82AAE will be repealed by **item 4 of Schedule 1**, effectively denying deductions for contributions to non-complying funds. **Part 2 of Schedule 1** will amend the *Income Tax Assessment Act 1997* to achieve the same effect.

Subdivision AA of Division 3 of the ITAA36 deals with when deductions for superannuation contributions will be allowed, which will generally be where contributions are made in respect of an 'eligible employee'. **Item 3 of Schedule 1** will amend the definition of 'eligible employee' contained in section 82AAA to provide that a taxpayer claiming a deduction and an eligible employee cannot be the same person.

Application: The above amendments will apply to contributions made after the time of the Assistant Treasurer's announcement, ie. 4 pm on 30 June 2000 (**Item 11**).

The *Fringe Benefits Tax Assessment Act 1986* will be amended by **Part 3 of Schedule 1**. Section 136 of the Act contains a definition of 'fringe benefit' and lists a number of items that are excluded from the definition, including superannuation contributions. The amendments provide that superannuation contributions will only be exempt where the provision of superannuation benefits is to an employee, including where benefits are payable on the death of the employee.

Application: To contributions made after 7 September 2000.

Endnotes

1 *Australian Financial Review*, 28 March 2000 and 8 August 2000.

2 TR 98/D12.

3 Australian Taxation Office, *Media Release*, 28 October 1998.

4 The matter is further complicated by allegations of fraud or other improper dealing, including those associated with the Petroulias case. The Commissioner stated in a recent speech '…it is equally clear at law that if a ruling was issued for an improper or fraudulent purpose it cannot be binding…' (http://www.ato.gov.au/content.asp?doc=/content/Corporate/sp200007.htm) This assertion may be tested in the current RPC case referred to later in the background.

5 TR 1999/5.

6 Op. Cit., 26 March 1999.

7 Following the internal review a more thorough review of the ruling system was conducted and the report of that review, known as the Sherman Report, was addressed by the Commissioner in a speech to the Tax Institute dated 15 November 2000. The Commissioner announced that in future private binding rulings would be published after material which could identify the applicant was deleted and that, subject to minor exemptions, the ATO would no longer issue binding opinions. The Commissioner also suggested that 'perhaps the time has come' for broader regulation of tax shelter promoters, including their registration. http://www.ato.gov.au/content.asp?doc=/content/Corporate/sp200007.htm

8 Op.cit. 19 May 1999.

9 The ATOs views on the tax treatment of the various EBAs is outlined in more detail in the various Schedules attached to Media Release of 19 May 1999 announcing the release of the final ruling.

10 *House Committee Hansard*, 11 May 2000.

11 In the context of the answer this estimate appears to relate to all EBAs and is not restricted to share ownership schemes which were the subject of the Committee's inquiry. Ibid., 11 May 2000.

12 See, for example, evidence given to the Standing Committee on Employment, Education and Workplace Relations, *House Committees Hansard*, 11 May 2000, p. 345.

13 *House Committees Hansard*, 11 May 2000, p. 345.

14 Assistant Treasurer, *Media Release*, 30 June 2000.

15 At http://www.ato.gov.au/content.asp?doc=/content/Corporate/sp200007.htm

16 Evidence given to the Standing Committee on Employment, Education and Workplace Relations, *House Committees Hansard*, 11 May 2000, p. 361-2.

17 *Australian Financial Review*, 8 August 2000.

18 Ibid., p. 356.

19 Assistant Treasurer, *Press Release*, 18 February 2000.

20 Evidence to the Standing Committee on Employment, Education and Workplace Relations, *House Committees Hansard*, 11 May 2000, p. 356.